ACCEPTANCE AND FOREIGN BRANCH POWERS UNDER THE PROPOSED FEDERAL RESERVE ACT[1]

JASON A. NEILSON

Brown Brothers

IT is venturesome to offer a decided opinion of the manner in which the foreign exchange functions would work out under the federal reserve act of 1913. The ordinary citizen who is but a casual observer and who has taken no intimate part in the actual framing of the law finds some parts not clear. Remarks at this time as to these functions of the federal reserve or national banks will therefore be most useful if they serve to open real public discussion, to the end that the banker and the merchant may through study obtain a clearer idea of the intentions of the law makers and of the possibilities of financing foreign trade under the proposed law. Attention should also be given to the matter in order that decisions may be obtained from the Federal Reserve Board as early as possible after the banks have agreed that it is possible for them to work under the new law.

Aside from the measures providing for the protection of the gold stock, the bill revised to September 18, 1913, contains other foreign trade items in sections 14 and 28.

Section 14 reads:

Any national bank may, at its discretion, accept drafts or bills of exchange drawn upon it, having not more than six months' sight to run, and growing out of transactions involving the importation or exportation of goods. No bank shall accept such bills to an amount equal at any time in the aggregate to more than one-half the face value of its paid-up and unimpaired capital.

Upon the endorsement of any member bank, any federal reserve bank may discount acceptances of such (member) banks which are

[1] Read at the meeting of the Academy of Political Science, October 15, 1913.

based upon the exportation or importation of goods and which mature in not more than six months and bear the signature of at least one member bank in addition to that of the acceptor. The amount so discounted shall at no time exceed one-half the capital stock of the bank for which the rediscounts are made.

Section 28 reads:

Any national banking association possessing a capital of $1,-000,000 or more, may file application with the Federal Reserve Board for the purpose of securing authority to establish branches in foreign countries for the furtherance of the foreign commerce of the United States. * * * such application shall specify * * * the amount of capital set aside for the conduct of its foreign business at the branches proposed. Every * * * association shall conduct the accounts of each foreign branch independently.

The acceptance privilege, or borrowing power, granted national banks for foreign trade bills, seems to stand out as the key to the changes in our national banking system which bear upon foreign trade. Incidental thereto are (a) the facilities for the rediscount through the federal reserve banks of bills bearing such acceptance and (b) the foreign branch privilege. Other American banking concerns have possessed the acceptance privilege, but up to this time, national banks have been forbidden to incur contingent liabilities in a direct manner by lending their credit in this way. There is danger that some who are not familiar with the uses of this class of credit power may avail themselves of it in a way that will injure our present foreign trade credit facilities. They may also see a chance to open an office in London and sell their acceptance in sterling, thus competing with friends in a field already well covered.

If a merchant has access to first-class financial advice, he knows that at the present time imports of merchandise can be freely and economically financed by anyone in proper credit, by means of the sterling commercial credits system. There is no lack of facilities.

The use of these facilities, however, involves the use of London acceptances and in this connection it has often been

said that we should not have to pay tribute to English bankers for this service, but should perform it for ourselves.

Of course, American banks can establish branches under the new law in London and if they desire they can usually sell their acceptances in sterling to a limited amount, but the economy of such action is doubtful. On the average, this method would be at least as wasteful as the present system, and therefore, the country as a whole would not be benefited.

In order to get sterling acceptance business, such branch banks would have to cut the rate below that quoted by their foreign competitors. Experience has shown that the present rates quoted by the joint stock banks in London are the very lowest possible. In fact, it has been claimed that competition has made them unfair to the acceptor, and that the present level will have to be raised eventually. The risks of the business demand at least that no further concessions be made if stability, profit and safety are to be considered. Suppose, however, that an American importer succeeded in buying an American bank's sterling acceptance at a commission rate below the English bank's quotation. He would find that the seller of the goods would not get so favorable a price for the bill as he would if it were drawn on one of the prime English banks or the important accepting houses of England. The seller of the goods would therefore have to raise his price, include the loss in his invoice, or get the difference out of the buyer in some other way. Thus the buyer would really pay the full English commission in an indirect manner for a credit not so favorable.

The time bill in sterling on a branch of an American national bank in London, would not bring so good a price as a bill on an English name, not only because the world's traders do not know it so well, but also because the London discount market would look upon such as foreign bills, and would receive them usually at a higher rate of discount in only limited amounts, and quite often, in critical times, not at all. They would not be available for rediscount in the Bank of England, they would be handled simply on the basis of a loan, and the line of the endorser with the negotiator would be reduced accordingly.

Another reason why Americans as a nation should consider carefully the question whether or not they shall use their new acceptance privilege in any national bank branch established in London is that the price we as a nation pay for foreign capital under the existing acceptance system is an extremely reasonable one. If we had the power to take over to ourselves the present American business of this sort, would it be wise to do so? We are a growing nation, with need for foreign capital and with much in the way of undeveloped resources in our own land. Would not our invasion of the English market probably result in some restriction being placed on the present liberal lines of credit granted American banks and merchants by the London banks and discount houses? If so, it is of first importance that every effort should be made by American bankers and merchants to discourage any attempt to spoil the English acceptance business by means of cut rates, and to allow present relations in that market to remain undisturbed as far as possible.

On the other hand, some say that we could instruct sellers to draw in dollars on American banks in America, at say two, three, four or six months' sight, and not complicate matters by introducing another currency. In most of to-day's transactions, this would be working contrary to the great currents of trade and would be a handicap to our merchants. London is the clearing house for almost all the important international commercial operations of the world, occupying a position which is impregnable at present and which cannot be altered until the accumulation of a larger amount of capital at some other center has made a change possible. England's capital, which she has kept constantly employed in this business for many years, the volume of her foreign trade, her long established commercial connections and her reputation for conservatism, honor and fair trading, make sterling still the world's best commercial medium of exchange. The franc, mark and dollar exchanges are secondary, and while useful under special conditions, they do not always find the wide market that exists for sterling. Bankers and merchants everywhere have accounts in London, and deal in London funds. They figure more closely on sterling than they will

do on any other currency. Everybody everywhere knows the value of sterling. It is the most favorable of the exchanges and has the greatest stability. The minds of traders in all parts of the world have been trained to it for generations. The buyer and the seller in most places can get together on a closer basis through its medium than in any other way as things stand to-day, and until conditions radically change sterling is dominant in the world's trade. Other methods should be adopted to make the new acceptance privilege really serve the people of America.

Dollar acceptances are most promising from the viewpoint of developing a new field which will be permanent, on a fair trading basis, and truly our own. If they are ever to be received by the world on a high credit basis, they will have to be carefully introduced and their use will have to be properly restricted by the acceptors. The line of least resistance will be for us to try to conform with the customs of trading used by the rest of the world. If we find that our merchants can trade to advantage by the use of our dollar acceptance system, and that it has value in a certain part of the world, then we should introduce our system gradually in that part of the world and there only. We should by all means avoid any effort to force dollar acceptances. When the time comes that America has capital to spare from domestic enterprises for the financing of foreign trade, and when our position in trade in the world's markets is such that the men of other places think prices in dollars, when they have close relations with us, and when an active exchange market for dollars exists, then, but not until then, to any great degree, will dollar acceptances be economical and useful, and will find their field.

The real economic use for dollar acceptances will be found in financing trade with the countries in which dollars are the dominant exchange. The exceptionally long tenor of the foreign trade bills the federal banks will take, indicates that the framers of the bill have recognized this and have specially desired to help finance the long-time credits which our merchants have to give to meet German competition in Latin-American countries. These countries seem to be the most promising field in which to make dollars the dominant ex-

change, and here exists a chance to make a most satisfactory use of dollar acceptances, a use that will conform to the intention of the law makers and one that will be perfectly natural.

As to foreign branches — the spirit of these privileges is that such branches are to be established only where it is shown to the Federal Reserve Board that they will further the commerce of the United States. It would seem that the present method of reciprocal relations covers fairly well trade naturally clearing through Europe, but possibly a few of the largest banks may believe that their special interests make it desirable for them to have branches in London, Paris and Berlin. If such branches are conducted conservatively and for the good of the nation's trade, it may prove a difficult task to make them pay, inasmuch as reciprocal relations are partly destroyed and retaliation is invited. It is doubtful if many will find it worth while if they confine their activities to commercial banking.

The places on the American hemisphere, where our natural opportunities along this line appear to lie, will probably be ignored at first, and while branches might be useful in some of these places even at the present time, it is true that ventures in such countries are fraught with considerable danger when not manned by experts, and they should be entered into most carefully. There must be a good deal of business done by our merchants before it will be profitable to establish American banks in Latin-American countries. If there had been a quantity of profitable business in view, there are financial institutions already in existence who could have entered the field ere this, but few have done so.

The proposed acceptance and branch bank measures, therefore, may prove dangerous to our foreign trade if unscientifically used, but if they are carefully regulated by the Federal Reserve Board and confined by the national banks to their proper sphere of usefulness, they will work for good. It will take time to instal them in this way, however, and the present methods of financing imports and exports, which, after all, have a great many compensating advantages, will not change radically at once.